

Statement of the Chamber of Commerce of the United States

ON: DEVELOPMENT OF A NEW RETIREMENT SYSTEM FOR FEDERAL EMPLOYEES COVERED BY SOCIAL SECURITY

TO: HOUSE POST OFFICE AND CIVIL SERVICE COMMITTEE

BY: JAMES A. KLEIN AND MARTIN LEFKOWITZ

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The Chamber of Commerce of the United States is the world's largest federation of companies and associations, and is the principal spokesman for the American business community. It represents more than 180,000 companies plus several thousand other organizations such as local/state chambers of commerce and trade/professional associations.

More than 85 percent of the Chamber's members are small firms with fewer than 100 employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business — manufacturing, retailing, services, construction, wholesaling, and finance — numbers more than 14,000 members. Yet, no one group constitutes as much as 26 percent of the total membership. Further, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the 50 American Chambers of Commerce Abroad, an increasing number of members are engaged in the export and import of both goods and services, and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross section of its members serving on committees, subcommittees and task forces. Currently, some 1,800 business people participate in this process.

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DEVELOPMENT OF A NEW RETIREMENT SYSTEM
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before the

HOUSE POST OFFICE AND CIVIL SERVICE COMMITTEE for the

CHAMBER OF COMMERCE OF THE UNITED STATES

by
James A. Klein and Martin Lefkowitz
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Mr. Chairman and members of the Committee, my name is

James A. Klein, Manager, Pension and Employee Benefits for the Chamber of

Commerce of the United States. With me today is Martin Lefkowitz,

Director, Economic Trends and Statistics for the Chamber. We are pleased
to have the opportunity to testify on behalf of the Chamber of Commerce
of the United States, the world's largest federation of companies,
chambers of commerce and trade and professional associations.

We commend the Committee on Post Office and Civil Service for holding these hearings on the development of a new retirement system for federal employees hired after December 31, 1983, and who are covered by Social Security. For Congress to act expeditiously in developing a new retirement system is important so that newly hired federal workers may feel confident of a stable and financially sound retirement system that adequately meets their needs.

The Congress has before it a difficult challenge—but also a unique opportunity—to fashion a retirement system for newly hired workers. The challenge is to develop a system that balances the need of federal workers to be ensured adequate retirement coverage and the need of taxpayers to pay for an equitable and reasonably priced system. The opportunity, however, is to create an entirely new retirement system for federal workers, one that uses common practices in the private sector rather than the current Civil Service Retirement System (CSRS) as its basis. We hope the Chamber's comments will assist you in meeting this challenge and opportunity.

In 1983, this Committee and the Senate Committee on Governmental Affairs asked the U.S. General Accounting Office (GAO) to analyze information on prevailing features of retirement programs in the nonfederal sector. At hearings earlier this month, this Committee heard from the Comptroller General of the United States on the results of GAO's exhaustive study entitled Features of Nonfederal Retirement Programs, published in June 1984.

The GAO report used the Department of Labor's Bureau of Labor Statistics' 1982 study entitled "Employee Benefits in Medium and Large Firms." This study involved 976 pension plans covering 17 million participants. GAO also used extensive surveys conducted by four private firms and by the National Association of State Retirement Plan Administrators.

We urge the Committee to look carefully at the data compiled by the GAO. It provides an excellent analysis of the features of private sector retirement plans—at least among medium and large companies. Many small companies cannot afford to be as generous as medium and large companies and, therefore, do not provide any pension plan at all.

Federal employees deserve a retirement system no less generous than that found throughout the private sector. However, businesses and their employees whose taxes pay federal retirement benefits should not be asked to pay for a system more generous than that in which they themselves participate. For these reasons we ask the Committee to emulate private sector practices while developing the new system.

COMPONENTS OF A NEW RETIREMENT SYSTEM

The GAO report determined that retirement programs in the nonfederal sector, where they exist, typically involve Social Security, a pension plan and a capital accumulation plan such as a thrift or deferred compensation plan. Within these broad components, specific features of

private plans are commonly found. We will enumerate some of these features while answering the questions the Committee asked in its invitation to testify at this hearing. These questions involve cost, Social Security integration, employee contributions, vesting and funding of the new retirement system.

1. What should be the normal cost of the new system?

The employer cost of the current Civil Service Retirement System (CSRS) is an unacceptably high percentage of the total federal payroll. The Congressional Research Service estimates the cost at nearly 25 percent of pay. An independent study conducted for the Office of Personnel Management (OPM) found the cost to be 28 percent of payroll, as did the study by the President's Private Sector Survey on Cost Control (Grace Commission). If the Employee Retirement Income Security Act (ERISA) formula for funding the unfunded liability were required, the cost would exceed 70 percent of payroll.

In the private sector, however, the employer costs are much less. The same study prepared for OPM, mentioned above, found that private pension costs were 18 percent of pay, while the Grace Commission placed the figure at 17 percent. These studies looked at the norms in medium and large companies that have pension plans. Other estimates, including the U.S. Chamber's own annual Employee Benefits Survey and the U.S. Department of Commerce's Survey of Current Business, both of which look at the entire spectrum of business sizes across the economy, including those with and without pension plans, revealed the cost of retirement plans at between 4 and 5 percent of payroll.

The point is clear. By any measure, the cost of the present federal retirement system is inordinately high. The new system must seek to bring the normal cost of the retirement plan into accord with normal

costs in the private sector as a matter of fiscal responsibility toward the taxpayers who support the system, as a matter of equity between federal and nonfederal workers and as a matter of honesty toward the federal employees who are relying upon the ability of the government to pay the benefits they are being promised.

2. Should the new retirement system be integrated with Social Security?

The Social Security system replaces a higher proportion of earnings for people with lower average wages. The U.S. Chamber supports this "tilt" as a form of social insurance for lower-income earners. Because of this tilt, many pension plans are integrated with Social Security in that a portion of the Social Security benefits is deducted from the benefits the pension plan would otherwise pay under its benefits formula. This deduction tends to equalize the proportional wage replacement among higher and lower-paid workers when pension benefits and Social Security benefits are combined.

The GAO report found among the surveys it used to compile its report that between 64 and 96 percent of private sector plans were integrated with Social Security. The degree to which the Social Security tilt is offset and the method by which it is done vary among different pension plans. However, the extensive data compiled by the studies which GAO analyzed clearly suggest that the integration of Social Security and pension benefits is the predominant practice in the private sector and one that should be emulated in the development of the new system.

3. Should employees under the new retirement system be required to make contributions to the pension plan?

Federal employees covered by the CSRS are required to contribute to their pension plan. This is clearly contrary to the common practice in the private sector where between 78 and 93 percent of the pension plans are fully paid for by the employer, according to GAO.

Employer sponsorship, however, does not preclude the opportunity for voluntary employee contributions. As discussed above, capital accumulation plans are a typical feature of comprehensive retirement programs in the private sector. Whether it is in the form of a salary-reduction 401(k) plan or a thrift plan, the new system should encourage employees who can afford to do so to help save for their retirement. This will provide federal employees the same opportunity which many private sector employees enjoy, will allow federal employees to contribute toward their retirement income security, and will hold down the financial pressure on the federal government in determining its proper level of contributions.

4. What should be the vesting requirement under the new retirement system?

In the CSRS, employees are vested after five years. The GAO report demonstrates that an overwhelming number of private-sector pension plans provide for "cliff" vesting after 10 years. A small percentage of plans provide either for "cliff" vesting after a period other than 10 years or provide for graduated vesting. In the absence of any evidence showing that length of employment greatly differs between the private sector and the federal government, the period of service required for vesting that is found in the private sector should be adopted in the formulation of the new federal retirement system.

5. Should the new retirement system be fully funded?

The current CSRS contains an unfunded liability of over a half trillion dollars—a monumental level of future pension obligations for which no money has been set aside. This unfunded liability would never be permitted for private—sector plans which must meet certain minimum funding standards prescribed by law.

We recognize that stern measures must be taken to address the enormous unfunded liability of the CSRS, and the Chamber has often urged Congress to take these measures in order to instill sound management principles in our federal retirement system. Presented with the opportunity to create a new retirement system, we urge the Congress not to allow this problem to occur again.

If Congress adopts a defined contribution plan for new federal employees, the unfunded liability problem would not develop because, by its nature, the plan would not call for specific levels of benefits to be funded. If a defined benefit plan is favored, then to deal forthrightly with federal employees and to apply equitably the standards of law imposed on private plans, the Congress must require a plan that is fully funded. Since employees will already be covered by Social Security which is indexed, the new plan should follow the lead of private employers by not automatically indexing benefits so that the great unknown of inflation as a determinant of future liabilities may be avoided.

FISCAL RESPONSIBILITY IN DESIGNING A NEW PLAN

The question of funding the new plan cannot be evaluated in a vacuum. Present realities of the federal budget deficit cannot be ignored. In the private sector, a company or industry beset by financial difficulties typically does not negotiate for a new pension plan that is as generous as it might like to provide if times were good. Moreover, private-sector employees have recognized this and have been willing to make concessions in their pension plans--particularly with regard to benefits for new hires. No less should be expected of the federal government and its new employees at this time of financial hardship.

We do not advocate "balancing the budget on the backs of federal employees." But it would be a cruel hoax on newly hired federal employees to promise them a benefit level that we simply would be unable to deliver as they reached retirement age. It is not only the taxpayers

who would be hurt by an unrealistic pension system—but also newly hired employees—if Congress does not consider our nation's ability to pay for the system as it develops an appropriate level of funding. Fortunately, adhering to principles of comparability between the private sector and the federal government would be both equitable and affordable.

CONCLUSION

Our private-sector pension system provides an ideal model for the Congress to use in developing a pension system for newly hired federal employees. The mandatory inclusion of federal employees in the Social Security system places them in the same position as private sector employees and adds further credence to the belief that a private-sector type of retirement program should be developed.